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SUBJECT: EL SALVADOR ANNOUNCES NEW $800 MILLION PRECAUTIONARY FUND WITH THE IMF

REF: A. SAN SALVADOR 881
¶B. SAN SALVADOR 887

¶1. SUMMARY. The Government of El Salvador (GOES) and the International Monetary Fund (IMF) announced September 24 a preliminary agreement for a new, three-year $800 million Stand-By Arrangement (SBA). The GOES intends to treat the SBA as a precautionary credit line to strengthen overall fiscal and financial stability. As part of the SBA's conditions, the Funes Administration has also agreed to reduce the fiscal deficit from 5.4% of GDP to 2.8% by the end of their term in 2014. While the GOES should not need the SBA funds in early 2010, a slower-than-expected recovery, lower-than-expected tax revenues, or poor performance of new debt issuances could force it to tap the SBA by late 2010 or early 2011. END SUMMARY.

¶2. President Mauricio Funes, Technical Secretary to the President (Chief of Cabinet) Alexander Segovia, and Minister of Finance Carlos Caceres announced the new SBA while meeting with IMF Deputy Managing Director Takatoshi Kato and IMF Director for the Western Hemisphere Nicolas Eyzaguirre in Washington September 24. This replaces a fifteen-month $800 million SBA the GOES had secured in January. The new SBA will go to the IMF Executive Board in November for final approval. According to the GOES, the SBA will go directly to the Central Bank and does not require approval by the National Assembly.

¶3. According to the IMF, the main objectives of the program are to safeguard fiscal and financial sustainability under the dollarization regime, catalyze resources from private investors and multilaterals, provide space for countercyclical measures aimed at strengthening domestic demand in 2009 and 2010, and support the administration's development plan for 2009-2014.

¶4. Caceres stated that, as part of the SBA's conditions, the GOES will reduce the fiscal deficit from 5.4% of GDP as of June 1 to 5.1% of GDP by December. The GOES proposes to further reduce the deficit to 4.3% of GDP by the end of 2010 and to 2.8% of GDP by the end of the Funes Administration in 2014. The GOES will also commit to increasing tax collection from the current 12.5% of GDP to 14%. Other conditions include improving efficiency in tax collection and customs and rationalizing the GOES's subsidies for electricity, gas, water, and transportation. Funes announced that the GOES will soon present a package of fiscal reforms that will include changes to the Value Added Tax (VAT) Law, to the Income Tax Law, and the Penal Code. With these changes they plan to collect $250 million additional revenue in 2010.

¶5. COMMENT: The announcement is consistent with what IMF staff told Post in August (reftel A), including the relative lack of concern about fiscal deficits by the "new" IMF, though the agreement was reached faster than expected. The GOES has sufficient funds from other institutions where it should not need to access the

"precautionary" SBA through the first half of 2010, but a slower-than-expected economic recovery, lower-than-expected revenues from the proposed fiscal reforms, and/or a weak response to the GOES's pending Eurobond issuance (reftel B) could all force the GOES to tap SBA funds by late 2010 or early 2011 to address its fiscal deficits. END COMMENT.

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